Regulation impact statement: CPI indexation of fuel excise and excise-equivalent customs duty

What is fuel excise?

1. Fuel tax (excise or customs duty) is applied to all excisable fuel and petroleum products whether domestically produced or imported.

2. The rate applicable to each fuel varies, but the benchmark rate that applies to petroleum and diesel is currently set at 38.143 cents per litre. The tax is applied at the point at which the fuel enters the Australian market. For domestically produced fuels, this is generally at the point of wholesale, while for imported fuels, it is at the point of delivery for home consumption.

3. Indexation of fuel tax was introduced in August 1983 in order to maintain the real value of tax collections and to provide more stability for businesses and consumers by removing the need for discretionary changes to tax rates (larger amounts made less frequently). In March 2001, the then Government abolished the six monthly indexation of fuel tax rates, but continued to apply indexation to other excisable goods, such as alcohol and tobacco. This decision was taken following the introduction of the GST on 1 July 2000, as increasing world oil prices at the time gave rise to concerns that fuel prices would be pushed higher. Consequently, the fuel tax on petrol and diesel has remained at 38.143 cents per litre since then.

4. The *Australia's Future Tax System* report released in May 2010 recommended that revenue from fuel tax imposed for general government purposes should be replaced over time with revenue from more efficient broad-based taxes.

5. The report also recommended that fuel tax should apply to all fuels used in road transport on the basis of energy content, and be indexed to the consumer price index (CPI).

Why is government action needed?

6. Since the cessation of fuel tax indexation in March 2001 the real value of fuel tax has declined with inflation, creating significant difficulties for the Government to fund spending commitments, such as

new road infrastructure projects. At the time of the indexation freeze, fuel tax represented 43.4 per cent of the average national petrol price. By March 2014 this proportion had fallen to 25 per cent.

7. In the 2014-15 Budget the Government committed to increasing road expenditure, with around $26 billion of Commonwealth spending planned for road infrastructure projects. An increase in the rate of fuel tax would be used to help fund these infrastructure projects. This would create a link between the users of the road infrastructure and the payers of fuel tax whilst ensuring a predictable and growing source of revenue.

8. Unlike fuel, rates on alcohol and tobacco are currently indexed. Alcohol (excluding wine) is indexed to the CPI, which changes biannually in February and August every year. As of March 2014, tobacco has changed from CPI indexation to Average Weekly Ordinary Time Earnings (AWOTE) indexation and is now indexed in March and September every year.

What policy options are you considering?

OPTION 1: Biannual CPI indexation

9. Beginning 1 August 2014 the excise and excise-equivalent customs duty on all non-aviation fuels are indexed to the CPI, occurring on 1 February and 1 August each year thereafter based on the sum of the CPI movements in the two quarters prior to the indexation date.

10. The duty on gaseous fuels will increase on 1 July 2014 in accordance with their transition into the fuel tax system, and will then have biannual CPI indexation applied to them from 1 August 2014. On 1 July 2015 the duty rate will then rise by an interval such that it maintains a 50 per cent discount on the energy-content equivalent rate with the application of indexation.

11. For consumers of petrol and diesel, the reintroduction of indexation is expected to result in an initial price increase of around 0.5 cents per litre on 1 August 2014.

12. By the end of the forward estimates period in July 2018 the biannual indexation of fuel excise and excise-equivalent customs duty is estimated to result in a total increase in petrol and diesel prices of 4.1 cents per litre, which includes a 0.4 cent per litre increase in GST which is levied on the duty-inclusive price.

OPTION 2: Quarterly CPI indexation

13. Beginning 1 August 2014 the excise and excise-equivalent customs duty on all non-aviation fuels are indexed to the CPI, occurring on 1 February, 1 May, 1 August and 1 November each year thereafter based on the CPI movement in the quarter prior to the indexation date.

14. The duty on gaseous fuels will increase on 1 July 2014 in accordance with their transition into the fuel tax system, and will then have quarterly CPI indexation applied to them from 1 August 2014. On 1 July 2015 the duty rate will then rise by an interval such that it maintains a 50 per cent discount on the energy-content equivalent rate with the application of indexation.

15. For consumers of petrol and diesel, the reintroduction of indexation is expected to result in a price increase of around 0.5 cents per litre after two indexation periods.

16. By the end of the forward estimates period in July 2018, the quarterly indexation of fuel excise and excise-equivalents customs duty will result in a larger increase in petrol and diesel prices than the biannual indexation due to compounding effects.

OPTION 3: A one-off increase of four cents

17. On 1 August 2014 the excise and excise-equivalent customs duty rates on petrol and diesel are increased by 4 cents per litre, with all other non-aviation fuels having pro-rated increases. This would increase the duty rate on petrol and diesel from 38.143 cents per litre to 42.143 cents per litre.

18. Gaseous fuels would continue to increase at the same intervals as previously until they reach their full rate on 1 July 2015 and then have an additional 10.5 per cent increase on 1 July 2016, bringing the duty rate on gaseous fuels back in line with 50 per cent of the energy equivalent rate.

What is the likely impact of each option?

Fuel wholesalers and importers

19. The Australian Competition and Consumer Commission (ACCC) currently publishes an annual price monitoring report on the

Australian petroleum industry. The most recent was published in December 2013.[1]

20. In that report, the ACCC stated that the wholesale market for petroleum is dominated by four major players (BP, Shell, Caltex and Mobil). These four entities accounted for 92 per cent of wholesale petrol sale volumes in 2012-13.

21. According to further data provided by the Australian Taxation Office (ATO), there are fewer than 100 remitters of fuel excise (excluding aviation fuel remitters).

22. For the options which change the current treatment of fuel tax (all options), the initial compliance cost imposed on wholesale remitters is likely to be felt through the need for an update to their systems to enable changes to the rate they apply when on-selling the fuel.

23. As a result, the compliance cost assessment uses the average wage in the IT industry of $47 per hour and assumes an average of five hours to update each of the 97 fuel companies. This creates a total compliance cost for the industry of approximately $22,795 for all of the considered options (a Regulatory Burden and Cost Offset (RBCO) Estimate Table for option 1 is provided at Appendix A).

24. However, some of the oil companies may not need the initial update to their systems as they will already have the ability to account for changing duty rates.

25. There will also be ongoing compliance costs for the options, as a legislative change to the fuel excise and excise-equivalent customs duty will result in either biannual (Option 1), quarterly (Option 2) or once-off (Option 3) changes to the duty rate that the wholesalers charge purchasers of fuel. Each change with indexation will require the manual inputting of a new duty rate into the company's systems, with reference to the new duty rate announced by the ATO.

26. The compliance costs for this action are assumed to be completed by administrative staff paid an average of $27 per hour, taking half an hour to find and change the excise and customs duty rates in the company's system and done either biannually, quarterly or once only, depending upon which option is chosen. This creates a total compliance

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[1] Australian Competition and Consumer Commission (2013) *Monitoring of the Australian petroleum industry 2013 - Report of the ACCC into the prices, costs and profits of unleaded petrol in Australia*.

cost for the industry of $2,619 for biannual indexation, $5,238 for quarterly indexation or $1,309 for the one-off increase (which would be the same as for an annual indexation option).

27. The indexed rates of fuel tax will be calculated by the ATO every indexation period, which will save businesses the need to calculate the new rate themselves by applying CPI to the present duty rate.

28. The size of these compliance costs is likely to vary from wholesaler to wholesaler, with smaller remitters of duty likely to face greater compliance cost relative to the four large oil companies.

Households and businesses

29. By re-introducing biannual indexation by the consumer price index of excise and excise-equivalent customs duty (Option 1) for all fuels except aviation fuels, the Government would generate $2.2 billion over the forward estimates period.

30. The price impact of any increase in fuel excise and excise-equivalent customs duty will fall most heavily on households and owners of light commercial vehicles used on-road. However, there will be no increase in the compliance costs borne by these groups.

31. Similarly, the effect on demand of an increase in the fuel tax is expected to be minimal, due to the inelasticity of demand for most fuel products. The *Australia's Future Tax System* consultation paper noted that 'due to limitations in current technology and distribution systems, the demand for transport fuels is relatively unresponsive to price.'[2]

32. Fuel used in heavy (that is, more than 4.5 tonnes gross vehicle mass) on-road vehicles and business off-road use will not bear the burden of any fuel excise increases because of their entitlements to fuel tax credits. For off-road activities, this is the full reimbursement of fuel tax while for heavy on-road vehicles this is equivalent to the fuel tax rate minus the road user charge.

33. However, businesses with access to fuel tax credits may still face increased compliance costs. Fuel purchase records will need to be categorised before and after the indexation date and variable fuel tax credit entitlements will need to be calculated for standard reporting businesses with either quarterly or annual Business Activity Statements

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[2] Australia's Future Tax System (2008) *Consultation Paper*; http://taxreview.treasury.gov.au/content/downloads/consultation_paper/consultation_paper.pdf.

(BAS). This will occur under any of the considered options to change the duty rates (all options), but will be an ongoing cost every six- or three-month period under the indexation options (Options 1 and 2).

34. The indexation of fuel excise will also further affect those businesses which rely on their own software to calculate their fuel tax credit claims, as they will have to manually enter the new excise rate every indexation period.

35. The ongoing compliance costs for these actions depend on which option is chosen and may occur once-off, biannually or quarterly. Assuming that all (approximately 186,000) fuel tax credit claimants are similarly affected by either filing a BAS quarterly or annually or through having to update their own software every month, the compliance costs are estimated at $27 per hour for a single administrative staff member to either sort through the fuel purchase records or change the excise rate in the software within half an hour. This creates a total compliance cost for the industry of $5,037,903 for biannual indexation, $10,075,806 for quarterly indexation or $2,518,952 for the once-off increase.

36. Businesses with an entitlement to offsetting fuel tax credits may also face the possibility of increased cash flow issues due to a larger immediate outgoing of fuel tax, as they only receive the credit for fuel tax paid at the end of their tax period when they lodge their BAS.

37. As a result of the more frequent indexation periods and the fixed time costs of any rate changes, quarterly indexation (Option 2) would likely involve higher compliance costs than biannual indexation (Option 1).

Alternative fuels

38. The gaseous fuels are not yet through their transition into the fuel tax system, which is set to be completed on 1 July 2015. Reintroducing fuel tax indexation will further raise the scheduled increases in their fuel tax.

39. The Government announced in the 2014-15 Budget that it will make changes to the tax treatment of ethanol and biodiesel to end their respective industry support grants, the Ethanol Production Grants and the Cleaner Fuels Grants Scheme. This is planned to begin on 1 July 2015 with the immediate cessation of the grants and a simultaneous reduction of the excise rate on domestically produced ethanol and biodiesel from its current rate of 38.143 cents per litre to zero. The customs duty rate on imported ethanol and biodiesel will remain at 38.143 cents per litre. Over the following five years to 2020-21, both products will be phased into the excise system until they reach 50 per cent of the energy content equivalent

excise rate, similar to the expected treatment of gaseous fuels after 1 July 2015.

40. At current excise rates, 50 per cent of energy content equivalence would be 12.5 cents per litre for ethanol (increasing in 2.5 cent intervals over the five years) and 19.07 for biodiesel (in 3.814 cent intervals). However, during the transition period, ethanol and biodiesel will be subject to indexation along with other non-aviation fuels, which will further raise the scheduled increases in their excise.

Consultation

41. A targeted consultation process on the compliance costs associated with a change to biannual fuel duty indexation was undertaken. The four major fuel manufacturers in the Australian market (BP, Shell, Caltex and Mobil) have been consulted on the estimated costs associated with the reintroduction of fuel duty indexation

42. While the fuel manufacturers are not overly concerned about the costs of updating their systems, they do have concerns about the time between the announcement of the new duty rate each indexation period and its application on 1 August or 1 February as they consider this could lead to disputes over payments from customers.

43. These timing concerns are largely driven by the relevant CPI figures only being released in late July and late January for the August and February indexation periods, respectively. This gives the fuel manufacturers approximately one week to be forewarned of the new duty rate by the ATO and Customs. One weeks' notice for the new rate was standard practice in the years between 1983 and 2001, prior to the freezing of indexation for fuel products, and has continued to be standard practise for alcohol and tobacco duty (prior to tobacco moving to AWOTE indexation in March 2014).

44. Concerns were also raised about the impact of indexation on tying up working capital, as there is normally a delay between when the manufacturers remit excise and customs duty and when they receive payment from their customers.

45. Further, the fuel manufacturers also raised concerns about the costs involved with informing customers of changed prices. However, given the constant price volatility in fuel markets, the additional costs from fuel indexation involved with this are considered to be negligible in the context of the overall compliance costs of $5.1 million.

Conclusion and recommended option

46. In view of the Government's commitment to deliver new road infrastructure projects through a predictable, growing source of revenue, it is considered that the reintroduction of some form of indexation of fuel tax (Options 1 or 2) is the preferred option.

47. Given that biannual indexation was a standard feature of the fuel tax system prior to 2001 and due to the additional compliance costs expected from quarterly indexation (Option 2), the biannual indexation of fuel excise to the CPI from 1 August 2014 (Option 1), is the preferred option. In addition, in comparison to annual indexation, biannual indexation would also result in a larger source of revenue which would allow the Government to more easily fund spending on new road infrastructure projects.

48. To further simplify the compliance burden on businesses, rounding the duty rate of indexed fuels from three decimal places in a cent to one decimal place would also be recommended. On the current rate for petrol, this would have the effect of reducing the excise and excise-equivalent customs duty rate from 38.143 cents per litre to 38.1 cents per litre.

Implementation and review

49. The proposed approach is to biannually index non-aviation fuel excise and excise-equivalent customs duty to the CPI from 1 August 2014 by the introduction of legislation into the Parliament.

50. The legislation would modify the *Excise Tariff Act 1921* and the *Customs Tariff Act 1995*. These modifications will result in the reintroduction of the indexation to the CPI of excise and excise-equivalent customs duty on fuel products. In addition, the applicable duties will now be applied by rounding to one decimal place for the purpose of remitting excise and the claiming of fuel tax credits.

51. To ensure that the fuel tax credit system works effectively, modifications will also be made to the *Fuel Tax Act 2006*. These modifications seek to ensure that the same indexed rate is used for determining the amount of excise or excise-equivalent customs duty payable on the fuel and the amount of the fuel tax credit for the same fuel.

52. Further changes to the *Fuel Tax Act 2006* will also ensure that the road user charge is designated to three decimal places after the next determination by the Transport Minister as well as during the transition

period prior to this determination, in order to prevent additional compliance burdens through an early determination.

53. A separate Fuel Indexation (Road Funding) Special Account Bill 2014 will establish a special account in order to ensure that all net additional revenue gained from the indexation of fuel duty is used to fund the provision of new road infrastructure projects.

54. Consequential amendments will also be made to the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004* to ensure that the Cleaner Fuels Grants Scheme continues to fully offset the increased fuel duty applying to biofuels. Further amendments will be made to the *Excise Act 1901* and the *Financial Management and Accountability Act 1997* to ensure the proper functioning of the fuel duty indexation measure.

Appendix A: Regulatory Burden and Cost Offset Estimate Table

Regulatory Burden and Cost Offset (RBCO) Estimate Table

Average Annual Compliance Costs (from Business as usual)				
Costs	Business	Community Organisations	Individuals	Total Cost
Total by Sector	$5,063,317.00	$0	$0	$5,063,317.00
Cost offset	Business	Community Organisations	Individuals	Total by Source
Agency	$5,063,317.00	$0	$0	$5,063,317.00
Within portfolio	$0	$0	$0	$0
Outside portfolio	$0	$0	$0	$0
Total by Sector	$5,063,317.00	$0	$0	$5,063,317.00
Proposal is cost neutral? ☑ yes ☐ no				
Proposal is deregulatory ☐ yes ☑ no				
Balance of cost offsets (**$132,988,606.10**)				

A regulatory offset has been identified from within the Treasury portfolio. This offset relates to the Future of Financial Advice (FOFA) reforms.